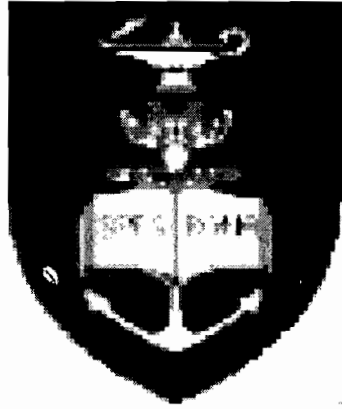


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**UNIVERSITY OF CAPE TOWN**



**SCHOOL OF ECONOMICS**

**INCENTIVES, INVESTMENT AND ECONOMIC  
DIVERSIFICATION: THE CASE OF  
MANUFACTURING DEVELOPMENT IN BOTSWANA.**

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**A Mini-Dissertation Submitted in Partial Fulfillment for the Degree of  
Masters of Commerce (MCOMM in Economics)**

**OCTOBER 2003**

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University of Cape Town

## **DEDICATION**

To my loving, compassionate and devoted wife; Kgomotso.

University of Cape Town

## **ABBREVIATIONS USED**

BEDIA	Botswana Export Development and Investment Authority
BOCCIM	Botswana Confederation of Commerce, Industry and Manpower
BNPC	Botswana National Productivity Centre
CEDA	Citizen Entrepreneurship Development Agency
CSO	Central Statistics Office
EPZ	Export Processing Zone
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
MCB	Motor Company of Botswana
NDP	National Development Plan
P	Pula (Botswana Currency)
SACU	Southern African Customs Union
SMME	Small, Medium and Micro Enterprise
SME	Small and Medium Enterprise
WTO	World Trade Organization
UNCTAD	United Nations Conference on Trade and Development

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## **ABSTRACT**

Botswana, which is widely known for its remarkable economic growth and prudent macro-economic management, was one of the poorest countries in the world prior to independence in 1966. The country was primarily a subsistence economy largely founded on agriculture, with a modicum of tourism. However, Botswana has since experienced rapid economic growth. This growth has been propelled by the mining sector, particularly the diamond industry.

The reliance of Botswana on a single commodity has prompted the government to engage in efforts to diversify the economy. This objective has been an important thread in the country's economic policy since the 1980's and forms the key theme of recent national development plans. Due to a small domestic market, Botswana has embarked on a strategy to promote export orientated companies and the facilitation of Foreign Direct Investment (FDI). Manufacturing, which is our primary focus, has been identified as a possible vehicle for economic growth and diversification, due to the fact that certain subsectors are labour intensive and could alleviate the country's pressing employment problem. We conducted a survey of fifteen manufacturing firms with the research objective of capturing their views on Botswana as an investment environment, the level of incentives, economic diversification and other related issues. The field research was based on individual interviews using a questionnaire.

We argue that factors, which previous studies identified as impediments to investment in the manufacturing sector, have largely been addressed. However, we concur that investment into this sector has not been as high as expected. Although incentive programmes have been established to promote investment, particularly into the manufacturing sector, research on the effectiveness of incentives is inconclusive. We argue that these incentives have to be retained in their current form.

In neighbouring countries the development of the manufacturing sector has frequently necessitated the establishment of Export Processing Zones (EPZs). EPZs have found

support from institutions such as the World Bank, which regards them as a powerful signal of a country's departure from import substitution to being an export-orientated economy. It is this paper's contention that the establishment of an EPZ is not the best policy option for Botswana. We argue that the objectives of diversification can best be achieved through a multi-tiered investment promotion strategy that will raise awareness of Botswana as an investment destination, facilitate the entry of foreign firms into the country, and identify valuable projects. The investment promotion strategy should seek to raise awareness of Botswana as a preferred investment destination.

# **CHAPTER ONE: INTRODUCTION**

## **1.1 BACKGROUND**

Prior to independence in 1966, Botswana was one of the poorest countries in the world, with an economy, which was largely based on agriculture and a modicum of tourism (Owusu *et al*, 1997). Agriculture accounted for 39 percent of the country's GDP. However, the share of agriculture progressively declined as the mining industry rose to prominence. The bulk of mining's contribution emanated from the lucrative diamond industry, as Botswana became the world's leading diamond producer (NDP 9, 2003). The sector's share of GDP grew from a negligible base at the time of independence, to 36.5 percent in 2000/01, after, reaching a highpoint of 52.6% in 1983/84. Mineral resources combined with prudent economic management led to a very rapid growth which improved Botswana's ranking from a low-income country to a middle-income country.

Botswana's accomplishment lies in wise management of natural resources and good governance, enabling a stable political and economic environment to prevail. Much of the mineral wealth was invested in health, education and infrastructure creating a foundation for long-term growth (UNCTAD, 2002). A major cause of concern, however, is the effective reliance of the Botswana economy on a single commodity, diamonds. The economy is vulnerable to the vagaries of volatile commodity prices, negative pressure on luxury goods resulting from the downturns in the international economy, the fickle fashion and luxury markets and the threat of public sensitivity to the "conflict diamonds" issue (Solomon, 2000).

Botswana has for the past few years engaged in an effort to diversify its economy. This particular ideal has been a key thread in the country's economic policy making since the 1980's and forms the key theme of recent National Development Plans. The theme of the current NDP is "Towards Realisation of Vision 2016: Sustainable and Diversified

Development through Competitiveness in Global Markets". The theme outlines the commitment of Botswana to being an outward oriented economy. The country has, therefore, embarked on a number of strategies including the promotion of export orientated domestic companies and the attraction of efficiency seeking Foreign Direct Investment (FDI), because of its small domestic market. In addition, Botswana has instituted a low corporate tax rate of 15%, abolished exchange controls, privatised state owned companies and established a tax holiday scheme. One of the sectors identified as a possible vehicle for economic diversification is manufacturing, due to the fact that investments within this sector are potentially labour intensive and might alleviate the country's pressing employment problem.

Efforts to attract investors into this sector have in other neighbouring countries such as Namibia and Zimbabwe necessitated the establishment of Export Processing Zones (EPZs) (Cowan et al, 1997). The idea of establishing EPZs as a policy tool to shift from an inward to an outward development strategy has found support in Southern Africa. The World Bank regards the establishment of EPZs as a signal of a country's departure from import substitution to an export- orientated economy (Jauch, 2003). Most EPZs use fiscal incentives as the major draw card.

Perceptions of the effectiveness of fiscal incentives in attracting FDI inflows have changed with the course of time. In the 1970's, the dominant view was that tax policy matters, but was not the most influential factor in the location decision making of multinationals. This strongly suggested that fiscal investment incentives offered by most developing countries were not effective in making up for fundamental weaknesses in the investment climate. The dominant view in the 1980's was that tax incentives do play a significant role. Recent debates revolve around the belief that the characteristics of multinationals determine the effectiveness that fiscal incentives have on FDI inflows. However, this research remains inconclusive (Morriset and Pirnia, 1999).

Most research in the field concludes that fiscal incentives are not a major consideration in the location decision-making process of investors, but can be effective once private investors have selected a particular region. This can lead to fiscal incentive bidding wars which solely benefit the private investors. The decision to invest in a particular locality seems to be more influenced by determinants such as economic conditions, political stability and, human capital. Fiscal incentives then tend to act as the “sugar that sweetens the cake”.

The purpose of this paper is to assess government efforts to promote economic diversification, particularly in the manufacturing sector, and to analyze the role of incentives, with the emphasis on the probable impact of EPZs on economic diversification.

## **1.2 STATEMENT OF THE PROBLEM**

Researching the issues of investment, incentives and manufacturing development will enable us to:

- i. examine the importance of incentives in the investment decision making process.
- ii. assess whether the degree and extent of the incentives offered are appropriate.
- iii. analyze the attractiveness of Botswana as an investment destination.
- iv. ascertain if current economic diversification efforts are adequate.
- v. analyze the relevance of an EPZ strategy in manufacturing development.
- vi. ascertain if there is a more appropriate strategy to attract investment in the manufacturing sector.

The general consensus is that Botswana needs to diversify its economy (Maipose, 2003). The way to achieve diversification is through the attraction of outward looking, long-term private investment (domestic and foreign). Even though there is abundant work on the

determinants of investment, there is a great divergence of perspectives on the issue. Views on the effectiveness of fiscal incentives in Southern Africa, particularly, SADC, are inconclusive (DPRU, 2000). There is, therefore, a need to pursue this topic so as to ascertain the merit of incentives that Botswana has instituted.

There are some key issues such as shortages of entrepreneurial and technical skills that have been stated as impediments to the economic diversification of Botswana, in major studies, such as the one by Cowan and Phetwe (1997) and a more recent study on the challenges and progress of globalization for Botswana by Harvey, Siphambe and Segosebe (2000).

A study undertaken by David Cowan and Moemedi Phetwe in 1999 on the feasibility of establishing an EPZ recommended against the establishment of such an entity. The main recommendation of this study was that there is a need to overhaul the key government departments responsible for initiating and implementing industrial policy. This paper will try to assess this recommendation in the light of the current environment and will solicit the opinions and perceptions of manufacturers on the issue, so as to formulate recommendations.

### ***1.3 OBJECTIVES OF THE STUDY***

The broad objective of the study is to ascertain the appropriateness of current efforts in attracting investment in an attempt to create employment, generate income, earn foreign exchange as well as gaining the perceived non-monetary benefits of such investment. There will be particular emphasis on an EPZ strategy as a potential engine of economic diversification.

The specific objectives are:

- i. to identify factors which influence the location decision of investors.
- ii. to profile manufacturing investors in Botswana
- iii. to determine the relevance of incentives on investment flows in Botswana.

- iv. to establish the probable impact of EPZ's on export diversification
- v. to draw conclusions and make policy recommendations on the basis of the findings of the study.

It is apparent that the country's remarkable economic growth has not translated into a significant degree of socio-economic transformation. This is reflected by the country's over-reliance on diamonds, and ongoing high unemployment/poverty levels. This study therefore attempts to analyze the relevance of manufacturing development and an EPZ strategy in pursuing the objectives of economic diversification.



## **CHAPTER TWO: A REVIEW OF THE ISSUES OF INVESTMENT, DIVERSIFICATION AND EXPORTS IN BOTSWANA**

### ***2.1 INVESTMENT IN BOTSWANA***

Botswana has a vibrant economy, which is unfortunately highly reliant on a single natural resource; diamonds. The country has embarked on a strategy to promote export-orientated companies, particularly in the manufacturing sector, in an effort to diversify its economy, because of its small domestic market. Measures include the introduction of a relatively low corporate tax rate of 15%, the abolition of exchange controls and the establishment of an international financial services centre. The small domestic economy has resulted in greater emphasis placed on the attraction of foreign investment. Mining has attracted significant FDI in Botswana, mainly because of political stability, well established mining codes and the quality of the resources (Solomon, 2000).

Some of the policies utilized by the country to attract private investment, especially export-orientated firms, include a sound fiscal and monetary policy, targeted and explicit subsidies with limited time frames and the recognition of the private sector as the engine of growth. This has resulted in the establishment of institutions such as the Botswana National Productivity Centre (BNPC) and the use of incentive programmes such as the Financial Assistance Policy (FAP) and those established by the recently introduced Citizen Entrepreneurship Development Agency (CEDA). An investment promotion agency, BEDIA (Botswana Export Development and Investment Authority), has been established with the aim of promoting Botswana as an investment destination.

### ***2.2 INVESTMENT TRENDS***

The Botswana government has accounted for the largest share of investment in the economy since 1982/83, and has a steadily increasing contribution to the total capital stock (CSO, 2002). The mining sector had the second largest share of the capital stock

from 1982/83 until 1992/93. However, the mining sector's share of capital stock has progressively declined and is now surpassed by finance and business services, and transport. The manufacturing sector, which is our focus, has been characterized by steady increases in the amount of investment, however, the sectors contribution to total capital stock has remained constant (Table 1). Investment in the country, even though dominated by the government, is sectorally diverse.

Table 1: Share of capital stock by sector, 2002 (percentages).

Sector	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00
Agriculture	1	1	1	1	1	1	1	1	1	1
Mining	15	14	14	13	12	11	10	9	9	8
Manufacturing	5	5	5	5	5	5	5	5	5	5
Water & electricity	8	8	8	8	7	7	6	6	6	5
Construction	3	3	3	3	3	3	3	3	3	3
Trade, hotels& Rest.	4	4	4	4	4	4	4	4	4	4
Transport etc.	10	10	10	9	9	9	9	9	9	9
Finance & Business. Services.	12	13	13	14	14	14	14	13	13	13
General government	37	38	39	40	41	42	44	47	48	49
Social & Personal Services.	3	3	3	3	3	4	4	3	3	3
Total	100	100	100	100	100	100	100	100	100	100

Source: *Statistical Bulletin Vol. 25*, CSO, 2002.

The country has experienced decreasing FDI flows. As depicted by Table 2, FDI has progressively decreased as a percentage of GDP since 1980. This has mainly been due to the slowdown of investments in the mining and manufacturing sectors (NDP 9, 2003).

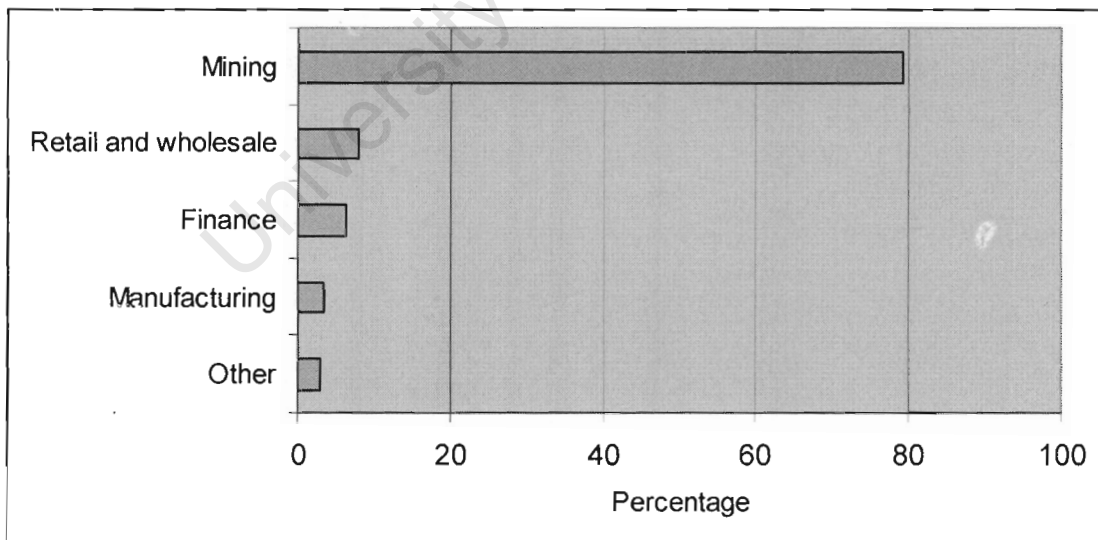
Table 2: FDI Flows into Botswana by Years, 2001.

Year	FDI inflows/GDP (per cent)
1980	10
1985	5
1990	3
1995	2
2000	1

Source: *Investment Policy Review of Botswana*, UNCTAD, 2002.

FDI has been critical in the diversification of Botswana economy away from agriculture to mining. It is also expected to contribute to the second phase of diversification, “beyond diamonds”. Botswana’s early opening to foreign investment led to large capital inflows of FDI in the 1970’s. The mining sector contributed 75 percent of the FDI stock in 1999 and has increased its share to 79.3 percent in 2000. The bulk of investment in this sector is by Debswana Diamond Company, a 50-50 joint venture between the Botswana government and De Beers. The second largest FDI stock contribution is the retail and wholesale sector which contributed 7.9 percent. The third largest sector is finance, which accounts for 6.3 percent of FDI stock, followed by manufacturing, with 3.5%. The latter sector plays a central role in Botswana’s strategy for development and is seen as the principal means through which the twin goals of economic diversification and employment creation can be realized. The rest of the FDI stock is accounted for by hospitality, construction, transport, storage & communication and real estate & business services (NDP 9, 2003).

Figure1: Share of FDI stock by sector, 2000.



Source: NDP 9, 2003.

Gross domestic investment has been variable for the past two decades. As shown by Table 3, it was at its peak in 1980, and is currently on the increase and is expected to

maintain the momentum. This optimism is fuelled by the governments focus on national business development, and the opinion by some economists, that the driving force for diversification should be domestic business. However, even though it contributes comparatively less to total gross investment, FDI remains critical for the transfer of managerial, technical and professional skills, hard and soft technologies and access to export markets (UNCTAD, 2002).

Table 3: Gross domestic investment in Botswana by Years, 2001.

	Gross domestic investment/GDP (per cent)
1980	37
1985	21
1990	32
1995	27
2000	28

Source: *Investment Policy Review of Botswana*, UNCTAD, 2002.

### 2.3 FDI IMPACT

#### 2.3.1 Savings and investment

FDI is particularly crucial whereby there is a scarcity of national savings. However, Botswana is fortunate as it has high national savings which has enabled it to co-finance FDI sponsored projects (e.g. the recent expansion of the Orapa diamond mine). However, the necessity of foreign capital to complement national savings cannot be over-emphasized. This is particularly true for Botswana as FDI is very crucial in identifying viable investment projects – as local entrepreneurial class is in its infancy – and signaling the country’s openness to investment.

### 2.3.2 Technology and skills

Most non-mining sectors in the country are technologically weak (Harvey *et al*, 2000). In the mining sector, which is Botswana's economic backbone, technology is constantly updated to maintain the long-term competitiveness of the mines, a condition that sustains the positive indirect financial contributions of FDI to the economy, in the form of taxes, royalties and dividends to local shareholders. Manufacturing, which is the focus of this paper, remains technologically weak, with low local technological capabilities (UNCTAD, 2002). Therefore, foreign investment projects which involve the importation of capital goods and associated technology are to be encouraged.

Even though the government has invested considerably in education, there is a chronic shortage of skilled manpower, as for a long time education was biased towards the needs of the public sector instead of the private sector (Harvey *et al*, 2000). FDI is, therefore, an important source of all types of skills. This can occur through the employment of expatriates, training of the local workforce and the movement of the local workforce from foreign affiliates to local firms. However, one can infer that there has been an increase in the number of skilled local workers as there has been a concerted national drive to "localize" staff, even at management level. Also, Botswana does have a large supply of trainable labour because of the considerable investment in education (Clover, 2003).

### 2.3.3 Employment and linkages

Despite very strong growth, Botswana has experienced persistent and rising unemployment. FDI has not contributed to employment as much as it has contributed to growth in production, exports and government revenues (Mhone *et al*, 2001; Maipose, 2003). Even though mining accounts for one-third of GDP it only contributes 3.5 percent of total employment (NDP 9, 2003). This is because large-scale mining is very capital-intensive, and therefore there is a need to focus on improving the inflow of manufacturing FDI as the sector is relatively labour intensive (NDP 9, 2003). However, the current development plan (NDP 9) indicates that both the services and manufacturing sector, have not had an improvement in their relative share of employment since 1994.

Linkages between domestic and foreign economic agents in Botswana have been weak, and have constituted a source of frustration for government policy makers ( Harvey et al, 2000). The reasons for weak linkages are complex. One of the most frequently advanced reasons is that there is a dearth of local suppliers to provide backward linkages for foreign firms. The reason advanced for this scarcity of local entrepreneurs is that government efforts to promote local entrepreneurship are fairly recent, as the primary focus had been the provision of employment opportunities for unskilled labour.

#### **2.3.4 Assessment**

The slow growth in employment in the formal economy and continuing high levels of income inequality and poverty are related to the lack of transformation and restructuring of the Botswana economy (Mhone *et al*, 2001). However, in a bid to deal with this problem, Botswana's economic strategy since independence has been directed by rapid growth sustained by economic diversification. The fact that the country's economy was small, reduced the potential of an import-substitution strategy. An important part of the strategy, therefore, has been diversification towards export-orientated goods and services (NDP 9, 2003).

FDI has played a crucial role in transforming Botswana since national independence. The country has had phenomenal success in generating savings and foreign exchange, but with limited success in areas like employment generation and linkages with locally owned businesses. Non-mining FDI inflows have generally been much lower than those anticipated by policymakers.

Diversification of the economy away from the dependence on the mining sector remains the overriding objective and the greatest challenge to the government as foreign exchange reserves will surely decline as the diamond boom comes to an end. Therefore, there is a need for policies that encourage the strengthening of local capabilities and enterprise. This presents a need for a consolidated focused strategy to attract FDI.

## **2.4 ECONOMIC DIVERSIFICATION**

Botswana faces the major policy challenge of turning the country's wealth into meaningful economic diversification for sustainable and broad based development (Maipose, 2003). Diversification in the case of Botswana can either mean the exploitation of different minerals apart from diamonds or the more favored route, which is diversification into sectors such as agriculture, manufacturing, tourism and financial services (Solomon, 2000). What is clear, however, is that the wealth and economic activity generated by mining may be short-lived and the unmanaged aftermath of mining, can be as destructive as the proceeds of mining were beneficial. Good planning and constructive intervention on the part of government and the co-operation of the private sector is therefore required. A facilitative role by the government is not adequate for broad based economic growth and diversification. The government needs to play both a facilitative and a directive role (Clover, 2003). Even though Botswana has embarked on a range of strategies to facilitate FDI the results have not been as anticipated as the country is still critically dependent on its diamond reserves (NDP 9, 2003).

### **2.4.1 Efforts at diversification**

The government of Botswana has in the past designed packaged incentive schemes to support the diversification of the economy. The Financial Assistance Policy (FAP) which began in 1982, has been the main incentive scheme aimed at encouraging investment and employment opportunities in a range of economic activities in Botswana. The FAP offered financial grants to encourage investment and employment in non-traditional sectors. Initially, the scheme focused on manufacturing and non-traditional agriculture but expanded over the years to include tourism, small-scale mining and related service businesses. Grants were linked to projected employment of skilled and unskilled Botswana labour (the capital grant), to wages paid to labour (the wage subsidy), tax holidays and a capital sales augmentation grant over a five year period. These were available to foreign and national investors, although, the capital grant was higher for national investors. The FAP was abolished for new applications in 2000, following a very critical evaluation of its rationale, effectiveness and administration by the Botswana

Institute for Development Policy Analysis (IDPA) in 2000. The main rationale for its abolition is widespread abuse and fraud, which resulted in an increase in expenditure that did not result in job creation or substantive business activity. In the 2001 budget speech, the then Finance Minister, Mr. Baledzi Gaolatlhe, announced that the FAP would be phased out and be replaced by various financial and technical support programmes to be administered by a new body, the Citizen Entrepreneurship Development Agency (CEDA). CEDA is expected to manage a Citizen Entrepreneurial Development Scheme, which will provide training and assistance, a Small, Medium and Micro (SMME) finance scheme, which will provide subsidized loans for citizens. Additionally, a Venture Capital Fund which will provide equity capital to citizen investors and joint venture partnerships between citizens and foreign investors. These schemes have been focused on providing access to financial resources and the training of local entrepreneurs (NDP 9, 2003). This is a positive step to address the shortage of indigenous private entrepreneurs (Maipose, 2003).

However; the lack of success of the predecessors of this scheme casts a shadow on its future success (NDP 9, 2003). This, together with the fact that manufacturing, which has been the focus of all these schemes, has not increased its share of FDI stock is not encouraging. This has prompted some media speculation in Botswana to the effect that the manufacturing sector might not be the best vehicle for diversifying the economy. Most proponents of this view argue that the industry has too many limitations and a small domestic market, and that the emphasis should rather be on the financial services sector (The Botswana Gazette, 2001). Proponents of such views do not take into cognizance the fact that, Botswana lacks skilled professional personnel, which is a crucial consideration in the services sector. Another option as stipulated by the president, Mr. Festus Mogae at a BOCCIM<sup>1</sup> (Botswana Confederation of Commerce, Industry and Manpower) conference on the 10<sup>th</sup> October 2003 is that there is no need for a choice between the manufacturing and services sectors, as it is possible that both the manufacturing and financial services could be concurrently developed.

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<sup>1</sup> The Botswana Confederation of Commerce, Industry and Manpower, BOCCIM, is a private non-profit making organization established in 1971. BOCCIM is recognized by the Government as the main "voice" of the private sector, and one of its main functions is to influence policy affecting it. BOCCIM's membership cuts across all areas of the economy and through all categories of the private sector.



## 2.4.2 Diversification within the manufacturing sector

As shown by Table 4 (pg 16), the manufacturing industry is diversified, with new non-traditional industries, such as the manufacture of radio, television and communication equipment, and electrical machinery and apparatus, being established. Many of the new entrants into the sector are technologically advanced industries as such, we envisage an improvement of technological skills. The clothing and other apparel industry is both dominant and dynamic as the industry has realized an increase in the number of establishments over the last two years.

Table 4: Number of operating manufacturing establishments by industry.2000.

Industry	Mar-98	Jun-98	Sep-98	Dec-98	Mar-99	Jun-99	Sep-99	Dec-99	Mar-00
Meat & Meat products	10	6	6	7	7	7	7	7	11
Dairy products	23	22	23	23	20	20	19	19	20
Grain mill products	25	26	27	26	26	26	28	28	31
Bakery products	63	64	61	62	62	66	66	65	80
Other food products n.e.c	30	27	29	34	35	36	33	33	42
Beverages	4	5	5	5	5	5	5	6	6
Textiles	83	87	89	91	92	91	91	91	93
Clothing & other apparel exc. Footwear	109	108	11	118	122	123	125	127	168
Tanning & Leather products exc. Clothing	16	15	15	14	14	113	13	13	14
Footwear	3	2	2	1	1	1	1	1	3
Wood and wood products	25	26	27	31	30	30	30	29	29
Paper & paper products	24	24	24	24	24	24	24	24	30
Printing and publishing	57	59	61	62	62	62	64	65	73
Chemical and chemical products	38	38	38	39	40	42	41	41	47
Rubber and Plastic products	12	12	13	15	15	15	15	15	17
Cement manufacturing	0	1	1	1	1	1	1	1	1
Non metallic mineral products	74	77	75	76	74	74	73	82	86
Basic metals	4	4	4	4	4	4	4	4	7
Fabricated metal prod. exc machinery	122	129	129	133	131	133	133	134	165
Machinery and equipment etc	7	6	8	9	9	9	9	9	11
Office, account & computing machines	2	2	2	2	1	1	1	1	1
Elec. machinery and apparatus n.e.c	0	0	0	0	0	0	0	0	1
Radio, tel. & commucation equipment	0	0	0	0	0	0	0	0	1
Medical, precision, optical instruments	5	5	5	5	5	5	5	3	3
Motor vehicles, trailers & semi-trailers	11	11	10	10	10	9	9	9	13
Other transport equipment	0	0	0	0	0	0	0	0	2
Furniture	30	31	32	30	29	28	28	28	39
Manufacture of Jewellery	0	0	0	0	0	0	0	5	7
Manufacturing of other products n.e.c	92	91	93	92	91	91	93	83	91
TOTAL	869	878	890	915	910	916	918	923	1094

Source: *Statistical Bulletin Vol. 25*, CSO, 2000. N.B: n.e.c = not elsewhere classified

### 2.4.3 Export orientation

Table 5: Exports of goods and services as a percentage of GDP by Years, 2001.

	Exports/GDP (percent)
1980	50
1985	62
1990	55
1995	50
2000	56

Source: *Investment Policy Review of Botswana*, UNCTAD, 2002.

Export performance, as Table 5 shows, has been inconsistent, mainly because of the volatility of the diamond market, which is affected by developments in the world market. The erratic performance of the exports segment was also in part influenced by the difficulties in the manufacturing sector. As Table 6 (pg 30) indicates, the manufacturing sector accounts for a significant share of total exports.

The government realizes that any sustainable expansion of the economy can only be achieved by putting in place measures that enhance the ability of the private sector to fully exploit regional and global markets. To this end, in 2001 the government established a database on the manufacturing and export capacity of Botswana's industrial sector. The purpose of the database is to serve as a reference point for identifying potential export products as well as new investments. The Botswana Export Development and Investment Authority (BEDIA) was also established as part of the effort to intensify export promotion (NDP 9, 2003). As part of its operations the agency undertook outward investment missions to a number of countries during 2001. By 2002, a total of 12 manufacturing companies had started operations and a further 15 projects were at an advanced stage of implementation as a result of these efforts (Sadcreview, 2003). Botswana aims to expand the operations of BEDIA through the establishment of a unit with the sole mandate of marketing locally made products.

There is an intention to formulate a foreign investment strategy, with the assistance of UNCTAD, which will be a framework for assessing Botswana's competitiveness in attracting FDI. The planned National Export Strategy will encompass the creation of a national export culture and the development of new export industries. These two strategies aim to improve the country's global competitiveness as well as reorientate the nation's consciousness towards export orientation.

#### **2.4.4 Assessment**

Policymakers have shown a serious commitment to economic diversification. They have also dedicated considerable effort towards creating an attractive climate for foreign investment in Botswana. This has included prudent macroeconomic policies, a willingness to commit financial resources to achieve diversification and a realization that global competitiveness is an essential ingredient to achieving sustainable development. In spite of all this, the government has not fully succeeded in attracting sufficient foreign investment to make a difference in broadening the structure of economic activities and creating new job opportunities. Overall growth and prosperity is still dependent on the mining sector (Sadcreview, 2003).

### **2.5 EXPORT PROCESSING ZONES**

Partly as a result of the difficulties experienced in diversifying the economy, there has been media speculation that Botswana should reprioritize strategy and establish Export Processing Zones (EPZs). Some government sanctioned reports such as Trans-Kgalagadi business opportunities survey, commissioned by the Ministry of Commerce in 2001 have hinted at the establishing an EPZ as a possible option. The rationale is that, EPZs could act as vehicles to promote rapid growth of manufacturing exports, with the aim of both creating employment and boosting economic development.

An EPZ, can either be a government or government/private sector initiative, and has the aim of creating an environment which is attractive to export orientated firms. In order to achieve this, the government normally waives much of the usual regulation that applies to

the firms that operate in the country and streamlines bureaucracy (Cowan *et al*, 1997). An EPZ can be located in a distinct geographical area , or firms can be granted EPZ status with the flexibility of locating anywhere within the country and a whole country can be declared an EPZ. The normal characteristics relatively common to all EPZs are:

- Duty free imports of raw materials;
- Exemption from national labour laws;
- Tax holidays and other incentives;
- Superior physical infrastructure and subsidized utilities; and
- Streamlined administration.

According to the World Bank, EPZs have three main goals. Firstly, they are established to provide a country with foreign exchange earnings by promoting non – traditional exports. Secondly, they are set up to create jobs and generate income. Lastly, they are established in a bid to attract FDI along with its perceived benefits of engendering technology transfer, knowledge spillovers, demonstration effects, and backward linkages (World Bank, 1998).

Most policymakers insist that EPZs are an efficient way of attracting foreign investors and stimulating exports of non-traditional exports in order to drive economic growth and development (Jauch, 2003). Moreover, given the enclave nature of EPZs, this can be achieved without the government having to deregulate other areas of the economy. EPZs are basically a way of providing export advantages without destabilizing existing manufacturers (Cowan *et al*, 1997). This type of policy is particularly pertinent for countries which want to pursue a managed liberalization approach to global integration.

### 2.5.1 Rationale for establishing EPZs

#### i) Employment creation

Lax labour laws in EPZs can contribute to the employment of unskilled and semiskilled labour (e.g Mauritius), this advantage that has been realized by many governments that have established EPZs, particularly in Asia (Cowan *et al*, 1997). However, there are some who argue that the employment created is not beneficial as the jobs created are of poor quality (Madani, 1999). This latter view, does not take cognizance of the fact that such employment even though appearing paltry, contributes significantly to the welfare of those who had no incomes before. This particular factor is important in a country like Botswana where 36.7 percent of the people were officially estimated to be living below the Poverty Datum Line (PDL)<sup>2</sup> in 2001 (NDP 9, 2003). Furthermore this type of employment, aside from the income earned, is valuable as workers learn industrial work discipline and routine (Madani, 1999).

#### ii) Skills transfer

The establishment of an EPZ provides indirect benefits such as on-the-job training of the general workforce and local middle- level managers. It also provides local businesses with operating examples of internationally competitive enterprises. The latter factor is particularly relevant for Botswana as entrepreneurship is in its infancy. There are also many cases of demonstration effects where EPZs have been established (Madani, 1999).

#### iii) Export diversification and revenue

Another potential benefit is that EPZs will increase the level of foreign exchange earnings and shift dependence from mineral revenue. Other scholars, such as Dot Keet (1996) argue that little revenue will accrue to the host country as most of the firm's earnings are spent on imported components and profits are remitted to parent companies.

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<sup>2</sup> Poverty in Botswana is defined in terms of the Poverty Datum Line (PDL). In 2000, the income value of the PDL "basket of goods" for a single adult male in the rural areas of the country was about P120 per month. This corresponds to between US\$25 to US\$30 per month, thus corresponding to the international benchmark definition of poverty as having to survive on less than US\$ 1 per day (NDP 9, 2003).

This argument can be nullified if sufficient purchases of domestic inputs take place or if there are significant levels of domestic ownership (Cowan and Phetwe, 1997). Legislation to promote these objectives may however, become an impediment to inward FDI flows (Jauch, 2003). Most countries such as Namibia have chosen to encourage rather than enforce the attainment of these objectives.

iv) Business linkages with domestic economy

Business links with the domestic economy SMEs are an important benefit of EPZs, particularly if the links involve direct purchasing. These types of links can result in technology transfers, particularly, if technologically advanced EPZ firms purchase inputs from domestic firms.

This outcome might not be feasible if there exists a problem of low and unreliable quality of domestically produced inputs. This has prevented the formation of productive links in most developing countries. Low quality of domestically produced goods has been identified as a problem in Botswana and has led to the establishment of the Botswana Bureau of Standards (BOBS). Since its inception, 120 standards, which have impacted positively on the quality of goods and services, have been declared and programmes are in place for the certification of quality goods. There could be an advantageous symbiotic link between the goals of an EPZ and BOBS, however, currently, domestic linkages would be weak.

### **2.5.2 Should an EPZ be created in Botswana?**

The establishment of an EPZ in Botswana may help address the key problems facing the development of non-traditional exports, such as:

- Shortage of serviced land for industry – this can be achieved through servicing of locations specified for EPZ activity;
- Lack of entrepreneurial skills – this can be achieved through the transfer of skills by multi-nationals with broad depth of human resource management experience; and

- Excessive bureaucracy/regulation – by their very nature, EPZs are intended to reduce or streamline bureaucracy.

Nonetheless, a factor to consider is that the establishment of an EPZ could contravene the terms of the SACU agreement. Under the SACU agreement even if the imports needed to make a good are initially allowed into Botswana duty free, once a good is exported to other countries of the Union, Botswana is required to collect the customs duty not paid on the imported components of the product. As a result, a traditional EPZ can only operate in Botswana if exporters are selling entirely outside SACU, which could be the case if firms want to take advantage of the African Growth and Opportunity Act (AGOA), of which Botswana is a beneficiary. This Act offers preferential access to the lucrative United States market. Another advantage for export orientated manufacturing companies is that Botswana is also signatory to the Benin-Cotonou agreement – which is a successor to the Lome Convention – which offers duty and quota free access to EU market.

Botswana has enacted the necessary legislation together with a conducive policy environment for foreign investment. As such, the country should be an attractive destination for investors. However, the response from prospective investors has not been as expected.

## **CHAPTER THREE: SURVEY OF MANUFACTURING FIRMS**

### **3.1 METHODOLOGY**

The field research was based on individual interviews, conducted through a questionnaire (Appendix 1). Such an approach allows a wide exploration of views (Hoinville *et al*, 1978), which was integral to our research objective. The main goal of the interviews was to assess corporate or firm perspectives on Botswana as an investment destination, the aim being to assess if the key conditions that have been cited as barriers to investment are still relevant. The research also strove to obtain information on:

- the relevance of incentives;
- the attitude towards foreign investors;
- employment creation, technological transfer and domestic links; and
- the importance of certain factors in the decision making process of firms.

#### **3.1.1 Data collection and analysis**

A total of 15 exporting firms were interviewed from a database of about 240 exporters in the manufacturing sector that was provided by Botswana Export Development and Investment Agency (BEDIA), which is the government institution tasked with the promotion of inward investment and exports. The interviews were conducted with the aid of a dictaphone. This was done in an effort to fully capture the opinions and perceptions of the respondents in greater depth. Thirty-one firms were approached for interviews, of which fifteen were willing and available to be interviewed. The firms were selected randomly and as such the sample included firms of varied sizes (in terms of revenue per annum and number of employees).



## **3.2 SURVEY RESULTS**

### **3.2.1 Current investment profile**

A profile of current investors is necessary so as to ascertain the effect of current policies in attracting investment, and how they can be re-orientated, if there is a need, to attract greater numbers or a particular kind of investor. Issues to note are the origin of the investor, factors important in the location decision-making process of the investors, and the principal market.

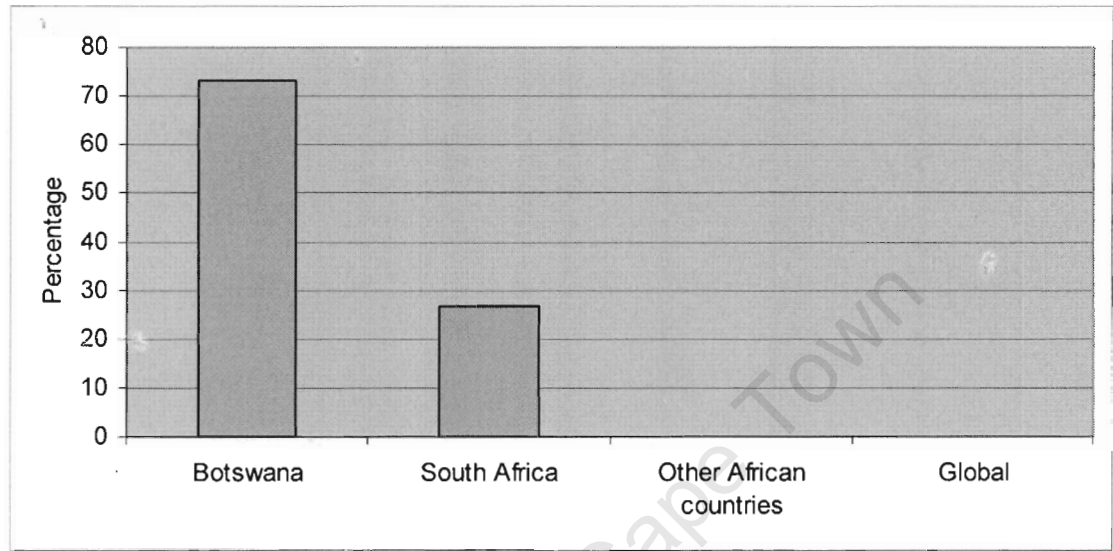
#### **i) Origin of the investors**

Of all the firms in the survey, only 20% were subsidiaries of foreign organizations. Most of the local firms were owned by permanent residents or “non-indigenous” Batswana, of Asian or European extraction. These owners had either been employed by foreign companies beforehand or had some capital and were influenced to start operations, by the attractive nature of government incentive programmes. This skewed ownership of assets has produced an undercurrent of mistrust and a thinly veiled dislike of non-indigenous Batswana, who are perceived to unfairly benefit from government resources. Most investors interviewed mentioned this issue. This same conclusion was reached by Maipose (2003), when he observed that, Batswana talk about government being in partnership with foreign interests, at the expense of indigenous people, and harbor a strong feeling that they have not fully participated in Botswana’s “economic miracle”. However, it is important to note that “non-indigenous” Batswana consider their country of origin to be Botswana. This sentiment is shared across the Botswana ethnic spectrum.

Only a few subsidiaries were fully integrated into the global network of their parent company. These companies felt that this integration had a positive impact on their production process and gave them an edge over competitors in terms of license to produce, business strategy and technical expertise. As an example, Barlow World Botswana, which is a large company (turnover per annum more than R10 million) with interests in various market segments ranging from paints to photocopiers, believes that the cooperative relationship with its mother company, particularly in the paint

manufacturing arena (it manufactures Plascon paints), offers it a technological edge over local entities, which regularly translates into increased market share.

Figure 2: Investors country of origin



Source: Own survey, 2003, N= 15.

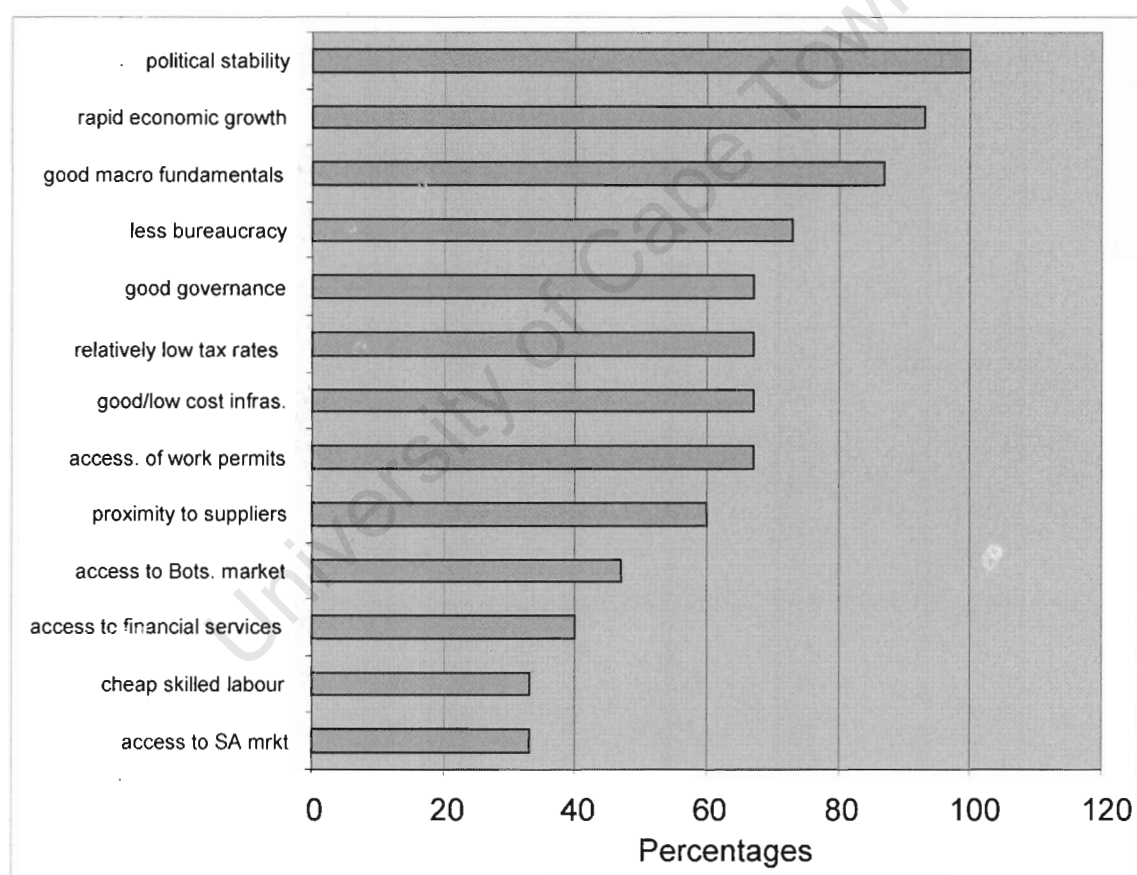
Figure 2, denotes that most of the respondents stipulated Botswana as the country of origin, with some notable investment from South Africa. This is supported by recent survey results, which have found that South Africa is a primary source of FDI flow to other SADC countries (DPRU, 2000). The main reason South African manufacturing firms invest in Botswana seems to be the relocation of production in order to secure or gain market share in Botswana. This is not surprising as most South African based enterprises have over the years been exporting to Botswana, and have developed a clientele base, which they want to preserve.

ii) Factors affecting the decision to invest

Respondents were asked to stipulate the importance of factors affecting the decision to invest, as Figure 3 indicates, political stability, was ranked as the most important consideration. Civil strife and political instability have long been documented to be

deterrents to private investment. It is encouraging that such a factor which has been stated in most studies as crucial in the location decision making process, is synonymous with Botswana. The same is also true for factors that have been deemed as important in the survey, such as rapid economic growth, good macroeconomic fundamentals, less bureaucracy, good governance, plus very robust institutional, legal and regulatory frameworks. All these requirements are quite established in Botswana, due to the country's prudent management of the economy. They have also induced a favourable access to international markets.

Figure 3: Major factors encouraging investment in Botswana.



Source: Own survey, 2003, N= 15.

N.B: The value on the Y-axis indicates the proportion of respondents who felt that a particular factor was important.

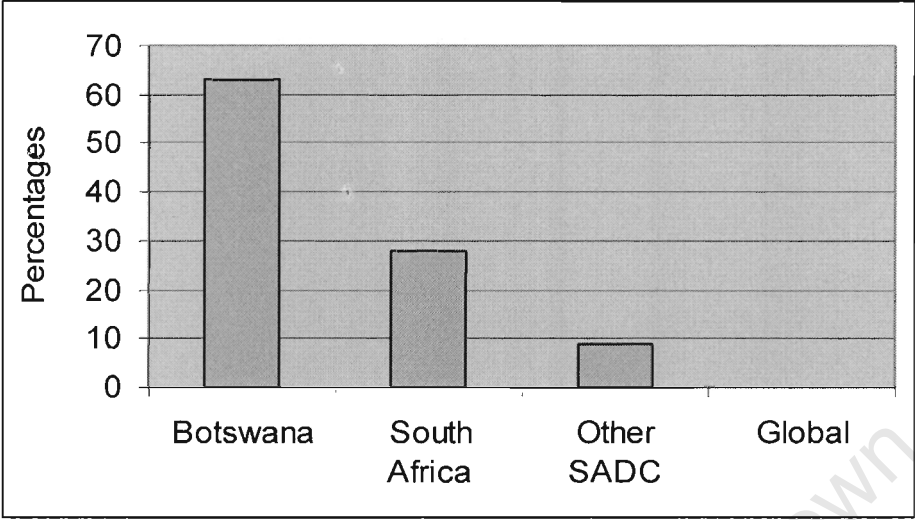
The results of Figure 3, on low tax rates, imply that it is a relatively important consideration in the decision of the manufacturers to invest in Botswana. It must be noted that the country has instituted a comparatively low tax rate of 15% for manufacturers, which, by the results of this survey, has borne a positive outcome. Literature on the effect of fiscal incentives on attracting investment is inconclusive. However, there is some consensus on the fact that fiscal incentives cannot be used to offset unattractive aspects of the legislative, regulatory or physical environment. Most respondents were of the opinion that fiscal incentives are effective.

Access to financial services was not an important consideration for most respondents as most had other sources of capital. This finding is reinforced by the fact that 80% were not aware of the availability of capital funds and working capital finance from the National Development Bank, and of those who were aware, only 20% utilized the facility. The most frequently recurring responses were that; the Bank charges were very high, and that they already had access to FAP funds.

Most of the respondents stated that access to the South African market was not an important consideration, with the Botswana market being more important. As Botswana has a small market, this particular observation indicates that most of the surveyed firms had a limited scale of operation. One might conclude that, Botswana has mostly managed to attract small and medium scale investors from within the country. Research by Harvey et al (1999) indicates that most Botswana based companies have managed to effectively compete with more advantaged South African companies, which implies that even though the companies started small, they were able to increase market share by venturing into regional markets. This is reinforced by the fact that 73% felt that their major competitors are located in South Africa.

The importance of the Botswana market relative to the bigger South African market is also apparent in Figure 4. This can be explained by the observation that most of these companies are small and as such would tend to be nationally rather than regionally orientated.

Figure 4: Principal market of the respondents.



Source: Own survey, 2003, N= 15.

Some importance is attached to the South African and SADC market, whilst the global market was of little or no importance to the respondents. Most of the firms sell only their surplus production to South Africa. It is also very apparent that most of the surveyed manufacturers are not highly export orientated and are more regionally than globally integrated as they have no export relationship with the global market. This shows lack of global business linkages, which could be a result of lack of exposure to the global economy.

Most investors were of the opinion that skilled labour is relatively expensive in Botswana. Contrary, to popular opinion that the lack of cheap skilled labour is an impediment to positive investment flows, we concluded from the survey (Figure 3), that the issue is important, but not a barrier to investment for most of the investors. Even though this response is surprising as there were a substantial number of respondents, who stated that the shortage of skilled labour was still a pertinent consideration, it might suggest that views differ according to contrasting experiences, mostly due to the inconsistent implementation of labour laws concerning the employment of aliens (Maipose, 2003).

### iii) Assessment

Most investors in the manufacturing sector are companies which originate within the country, and are induced to invest because of the favourable socio-economic climate and the ease of bureaucratic and administrative procedures. It is also interesting to note that the country has managed to achieve a political climate favourable to investment, which is encouraged by prudent economic management, a factor which is continually stated by the respondents as advantageous. Investors are essentially market seeking; primarily targeting the domestic market and secondarily, the regional market.

#### 3.2.2 Botswana as an investment destination.

A number of explanations have been advanced by various researchers as to why there has been limited progress in the development of non-traditional exports in Botswana, as shown in Table 6 (next page). Traditional Botswana exports are; diamonds, copper, nickel, and meat and meat products (Cowan *et al*, 1997; CSO, 2000). These goods still remain the major export commodities. There was rapid growth in non-traditional exports from 1993 to 1999 as the vehicles and parts industry had a strong upsurge, however this improvement was not long lasting. The difficulties in diversifying the sector are best illustrated by the case of the Motor Company of Botswana (Pty) Limited (MCB). The MCB was founded in 1997 as a joint venture between the government of Botswana and the Wheels of Africa group, which had a Hyundai franchise. The company established a plant in Gaborone, which assembled Hyundai motor cars from completely knocked down kits, primarily for sale to South Africa. The company was allocated land and a \$24 million loan from a government parastatal. The operation was hailed as the beginning of the country's export diversification epoch. Unfortunately, the MCB failed in the year 2000 and 600 people lost their jobs. Most of the failure of this enterprise has been attributed to financial mismanagement by executive management<sup>3</sup> of "Wheels of Africa" group which held the Hyundai franchise. The MCB and its distribution arm, Hyundai Motor Distributors Botswana (HMD) have been liquidated. The director of "Wheels of Africa", Mr. Billy Rautenbach, is facing related criminal charges in South Africa and has

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<sup>3</sup> They could not repay a total debt of US\$127 million to a consortium of international and regional banks (accessed at <http://www.innet.co.za/CarteBlanche/Display.asp?Id=1695> on 05-10-2004, 12H39)

relocated to Zimbabwe. MCB has become a by-word in Botswana for “fly-by-night” foreign investor and Botswana no longer exports Hyundai cars (UNCTAD, 2001).

There has been a general consensus (Cowan and Phetwe., 1997; Harvey, *et al*, 2000) on four key problems; shortage of serviced land, lack of entrepreneurial and technical skills, restrictive government regulatory constraints and high tariff levels on inputs from outside SACU. The results of the survey on the continued relevance of those issues are analyzed below.

Table 6: Exports by principal commodities (percentages),2000.

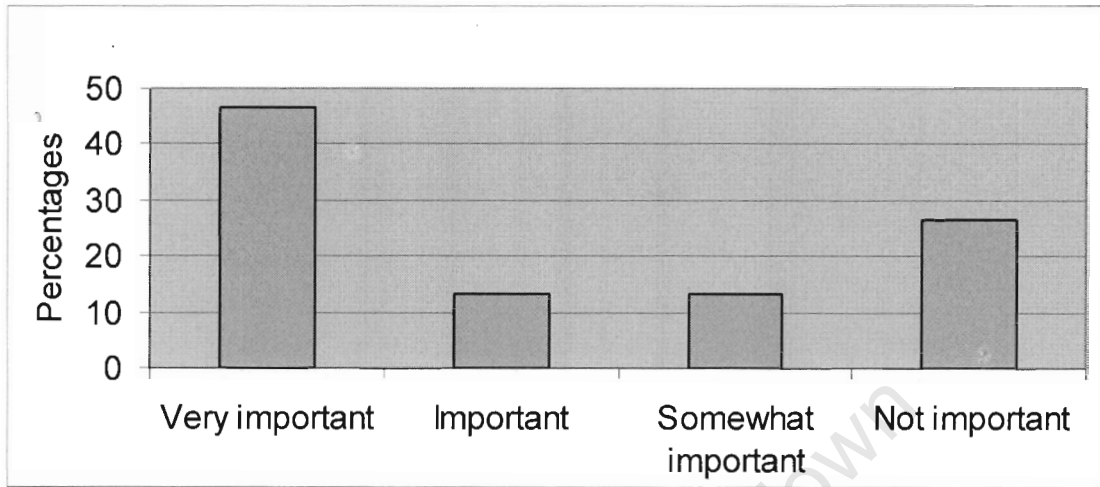
Year	Meat & Meat products	Live animals	Hides & Skins	Diamonds	Copper Nickel Matte	Textiles	Soda ash	Vehicles & Parts	Other goods	Total
1990	3.2	0.01	0.6	78.7	8.2	3.4	0	0	5.9	100
1991	3.3	0.02	0.5	78.7	7.9	3.3	0.6	0	5.7	100
1992	3.5	0.03	0.5	78.9	7.2	2.1	1.2	0	6.5	100
1993	3.8	0.02	0.5	78.2	5.1	2.2	1.2	2.1	6.9	100
1994	3.7	0.05	0.6	74.9	5.2	3.6	0.7	6.1	5.3	100
1995	3	0.04	0.6	67	5.5	2.5	0.4	16.1	4.8	100
1996	2.5	0.02	0.4	70.4	5.5	2.4	0.8	14.1	4	100
1997	2.2	0.02	0.3	73.8	4.6	2.4	1.1	11.4	4.2	100
1998	3.4	0.03	0.4	69.5	5	3.5	1.1	11.1	6	100
1999	2.6	0.02	0.2	74	5.2	2.4	1.1	7.5	7	100

Source: *Statistical Bulletin Vol. 25*, CSO, 2000.

i) Shortage of serviced land

In an effort to resolve the issue of shortage of serviced land, Botswana instituted a policy of servicing industrial and commercial land ahead of demand through the Ministry of Commerce and Industry and the Botswana Development Cooperation (BDC). The persistent view is that, the policy has been implemented on what should have been an adequate scale, but has been frustrated by government procedures and implementation. The result being that potential investors are not able to utilize highly visible and potentially lucrative developed plots, as they have been allocated to people who hold them in the hope of making a speculative profit by selling them when their market value has escalated because of scarcity.

Figure 5: Importance of the issue of serviced land as a constraint on investment



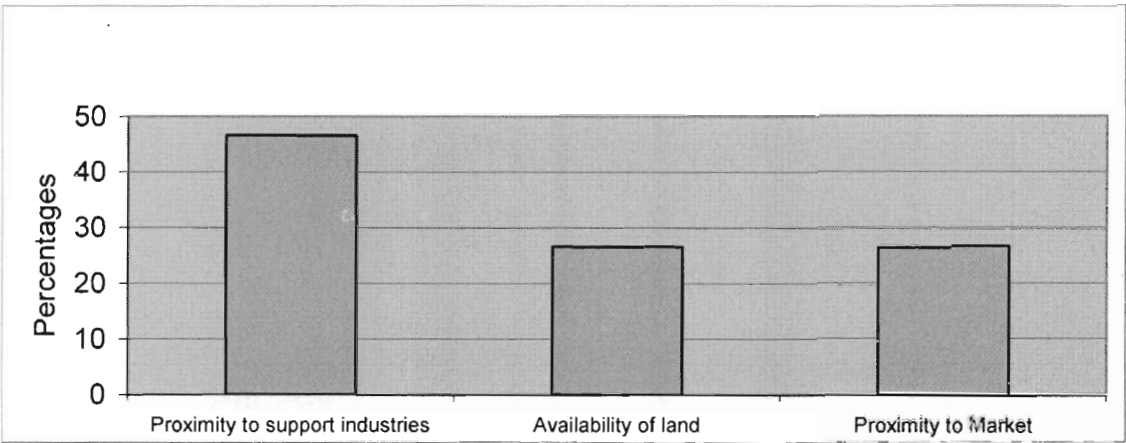
Source: Own survey, 2003, N= 15.

From Figure 5, it is apparent the issue of shortage of serviced land elicits divergent views, even though a majority of manufacturers still consider it to be a constraint. This can be interpreted to indicate that while government has made an effort to rectify the issue, the problem has not been satisfactorily resolved. Efforts to deal with the problem include the accelerated servicing of industrial land, the construction of factory shells and the establishment of institutions such as Botswana Development Co-operation (BDC) which assist investors to acquire land.

The problem is compounded by the fact that most of the land in Botswana is held under a communal land tenure system, which restricts the development of a normal market for industrial land (Maipose, 2003). There might be a need to re-evaluate the country's land tenure system, putting greater emphasis on availability of land for industrial purposes.



Figure 6: Principal reason for choosing a particular locality.

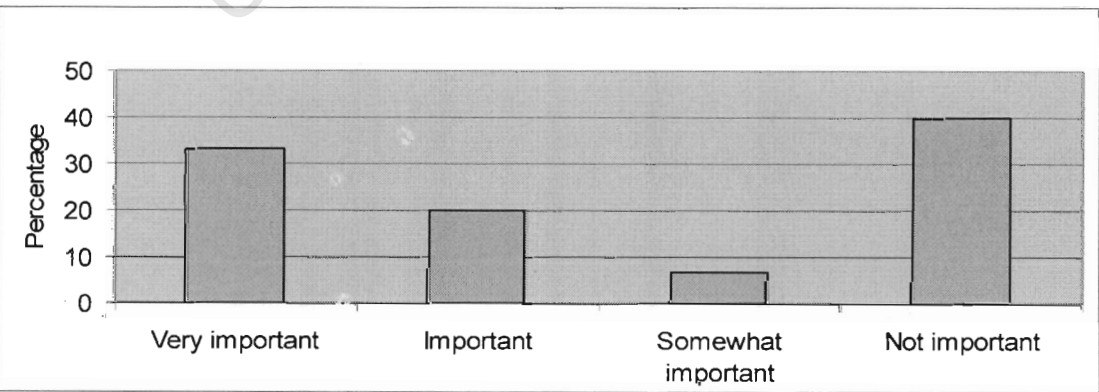


Source: Own survey, 2003, N=15.

Figure 6, highlights the fact that, even though the availability of serviced land is a consideration in the decision to invest; it is surpassed by other factors such as proximity to support industries. This can be interpreted to mean that there are other avenues which can be utilized to acquire appropriate business facilities such as renting. As such the main emphasis for potential investors in choosing a location is the proximity of production inputs and support industries.

ii) Shortage of skilled labour.

Figure 7: Importance of the issue of lack of entrepreneurial and technical skills as a constraint on investment.



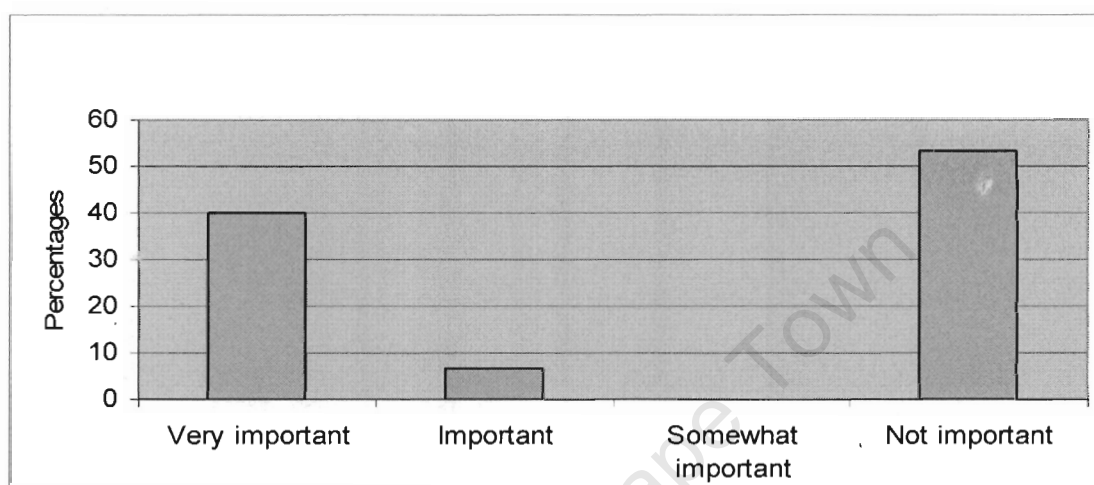
Source: Own survey, 2003, N=15.

Figure 7, shows that most surveyed manufacturers believe that there is a shortage of entrepreneurial and technical skills. The issue of lack of entrepreneurial and technical skills elicits divergent views. The divergence of views, might be due to the fact that some of the firms employ skilled non-citizens (which in the case of Botswana, tends to be Zimbabweans and Indians) and as such do not experience the shortage of skills, particularly with the current exodus of Zimbabweans to Botswana due to the current socio-political and economic upheaval in that country.

When Botswana gained independence, in 1966, there was a serious lack of skills. The country was a labour reserve exporting unskilled cheap labour to the then racist South Africa (Owusu *et al*, 1997). Botswana has now reached a stage whereby, there can be differing opinion on the availability of skills, which indicates that there has been an improvement in the quality of the workforce. This may be due to the substantial investment in education. The Botswana government, has since independence invested quite considerably in education, with this sector accounting for the fifth largest share of the development budget in National Development Plan 8 (NDP 8) and the current plan (NDP 9). As such, there exists an expectation that more could have been achieved in terms of skills developed. Nonetheless, as Gelb (2002) notes, there is no one to one correspondence between training expenditure and increases in human capital, since the expenditure on education and training tells us nothing about the quality of the training, or the extent to which it is firm-specific.

iii) Restrictive government regulatory constraints.

Figure 8: Importance of the issue of restrictive regulatory environment as a constraint on investment.



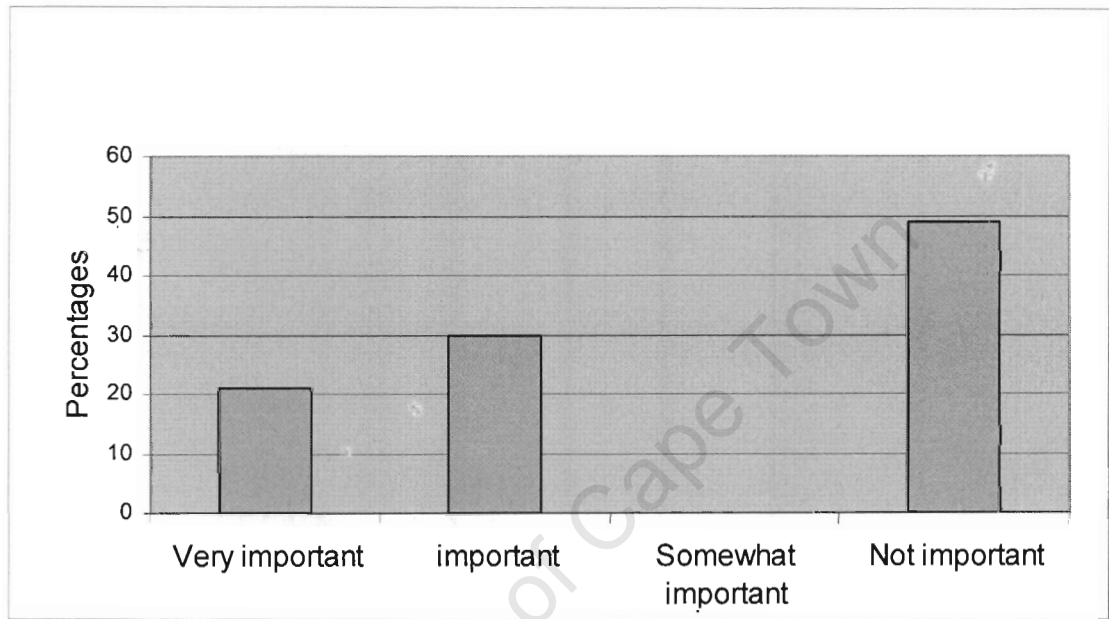
Source: Own survey, 2003, N=15.

From Figure 8, it is apparent that most of the manufacturers are of the opinion that government regulatory constraints are not major constraints on their performance. Furthermore, about 73% stated that, the fact that there was less bureaucracy was very important in selecting Botswana as a location option. Figure 3, shows that overall, most investors are of the opinion that the levels of bureaucracy are acceptable. However, there is a significant proportion of manufacturers who hold the view that government regulatory constraints are restrictive. This particular segment felt that, they had to interact with a myriad of government agencies to obtain all the necessary permits, licenses, approvals, and clearances, and they advocated for the creation of a “special” license which will be able to provide all the necessary bureaucratic clearances. However, there is bound to be a problem with the creation of such a license as different ministries have differing mandates and responsibilities, which would be undermined by such a dispensation. The conclusion is that most manufacturers are of the opinion that government regulations are not restrictive and there is no problem of oppressive

bureaucracy. As such the current government administrative procedures are not an impediment to investment.

iv) High level of tariffs on materials imported from outside SACU

Figure 9: Importance of the issue of high tariff levels on inputs from outside SACU as a constraint on investment.



Source: Own survey, 2003, N= 9/15

The majority of the manufacturers for whom the issue was applicable felt that the high level of SACU tariffs was of no consequence. The question was not applicable to a significant proportion of the respondents as most of the respondents purchased the bulk of their inputs from within SACU. This may imply that most manufacturers in Botswana are not globally integrated. However, the current EU/ RSA agreement on trade, development and co-operation, will have the effect of facilitating easy access of inputs to Botswana through its membership of SACU. Notwithstanding the fact that the same agreement will increase competition for the SACU market, which can be detrimental for the local small and medium enterprises. It can also increase competition for FDI between South Africa and other SACU members.

## v) Assessment

Overall, Botswana has achieved much in terms of creating a conducive climate for domestic and foreign investment. The impression is that there have been some improvements in the attractiveness of Botswana as an investment destination and some success in mitigating against those factors, which had been cited as impediments to investment. These efforts may translate into a much-needed FDI package, which is perceived to include managerial, technical and professional skills, appropriate, and modern technology, and access to export markets.

The divergence of views on the issues of serviced land and skills indicates that the concerns have not been adequately resolved. The fact that the government has allocated about \$25 million on the next development plan period (NDP 9) for the purchase of freehold farms for residential, commercial and industrial purposes (NDP 9, 2003), is indicative of the urgency, with which the government pursues the issue of land.

Botswana has created a favourable administrative environment with the objective of attracting investments. This is crucial as administrative procedures can pose serious impediments even in countries with an apparently liberal investment environment, as sometimes broad policy reforms do not actually translate into improvements in the various bureaucratic processes that investors have to go through.

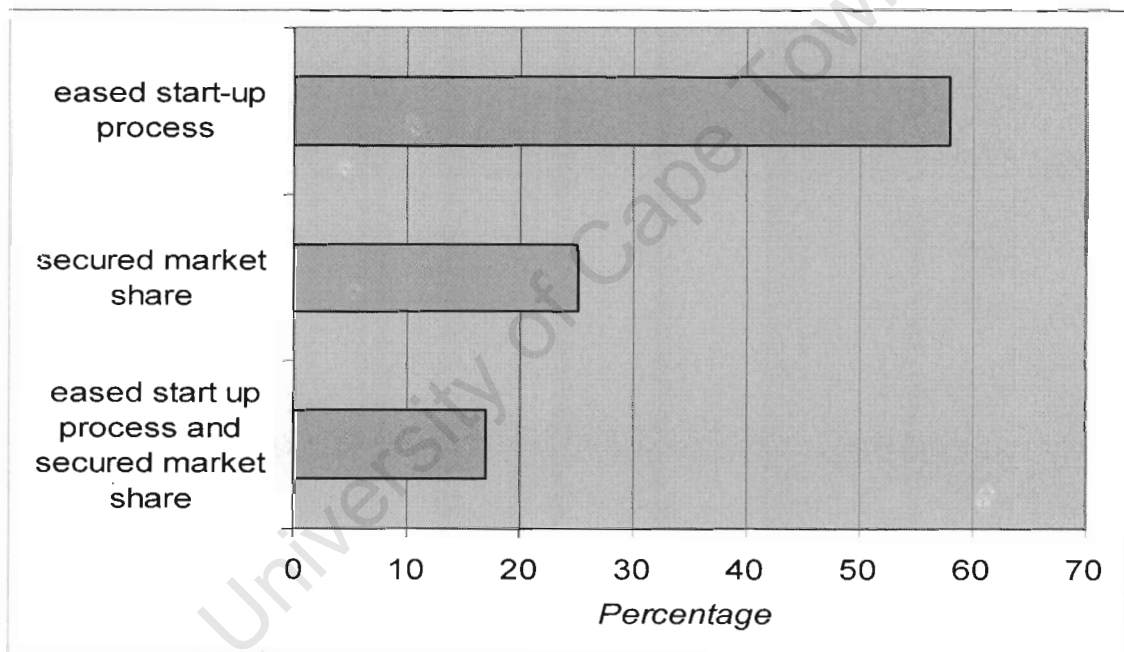
### **3.3 KEY ISSUES**

#### **3.3.1 Relevance of incentives**

An overwhelming majority of the surveyed investors felt that incentives schemes, in particular, the FAP played a role in their location decision making process. The most prominent role for incentives in those firms, was that they assisted the company during the crucial start-up process. This was achieved through the provision of the requisite finance and assistance in the acquisition of land, which was part of the provisions of the Financial Assistance Policy (FAP) incentive programme.

As Figure 10 illustrates, the incentives helped to secure market share when the firms were operational through the sales augmentation and unskilled labour grant, which were all part of FAP. Some of the firms for which the incentives played a role benefited from both the assistance with the start-up process and the securing of market share. The incentives had no role for about 20% of the firms. This assertion is supported by the fact that the country had relatively less bureaucracy than other possible investment destinations, a factor which was significant in the decision to invest in Botswana.

Figure 10: Assistance derived from incentive programmes.



Source: Own survey, 2003, N= 12/15.

When asked about the usefulness of incentives in the operations of their firms about 80% stated that they are very useful and 20% stated that they are useful to a limited extent. This can be interpreted to mean that investors have incorporated the role of incentives into the operations of their firms, which could be detrimental if the incentive programmes are discontinued.

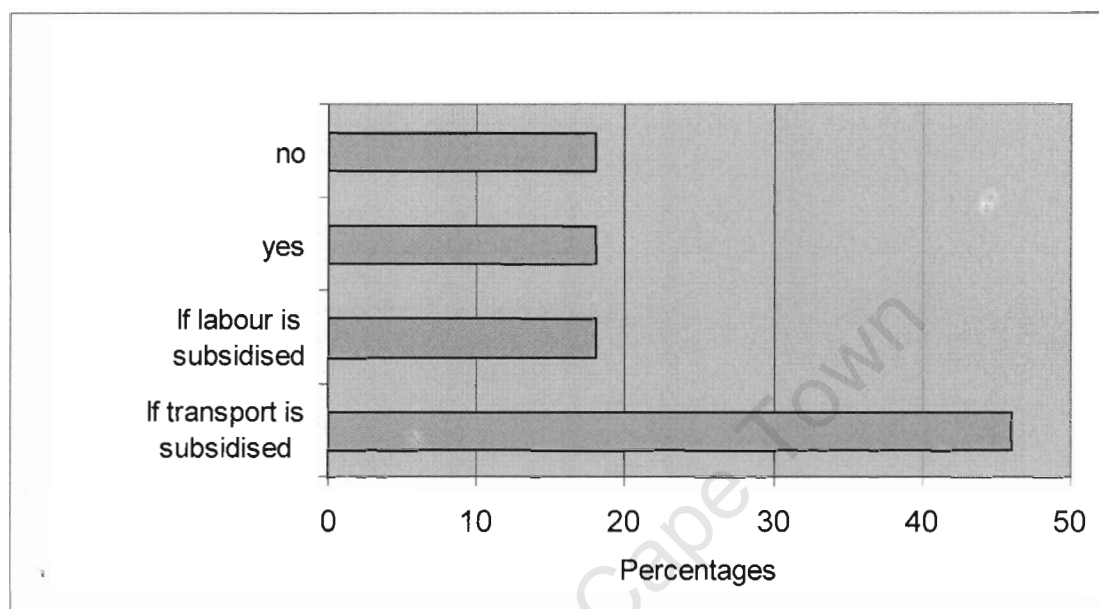
i) Assessment

Incentives, contrary to some opinions have been instrumental in promoting investment. Most manufacturers state that they were instrumental in the decision to invest in Botswana and were crucial in the initial stages of operation. Incentives are very important in the current operations of about 80% of the firms and are felt to be attractive. As such, the conclusion is that the current crop of incentives are adequate and essential. Most manufacturers believed that potential investors are aware of these incentives. The minority that felt that the incentives could be made more visible, were of the opinion that there should be enhanced utilization of the media and active participation in trade shows or greater utilization of foreign missions.

When a survey such as this, solicits answers from beneficiaries of governmental schemes there is potentially an element of bias. The respondents may have a tendency to furnish answers that will serve their best interests. Respondents were therefore made aware that this is an academic exercise, and would not directly influence government policy. Incentives have in the past been instrumental in attracting “footloose” investors, who have enjoyed the generous grants offered by the government and then disappeared. There have been in the past numerous well documented cases in the media of investors particularly, in the garment manufacturing industry, taking advantage of incentives under the FAP scheme and vanishing as soon as the last grant has been remitted. Most third world policymakers believe that incentives have lost their effectiveness, as investors interested in long term investments look at long term profitability without incentives (DPRU, 2000). However in the case of Botswana, taking cognizance of the response from manufacturers, the restructuring of FAP into CEDA, extensive utilization of the special 15% manufacturers tax, and the way the incentives are integrated into the daily operations of the firms, opinion is that the incentive schemes have to continue, especially as local manufacturers depend on the schemes. Furthermore, they encourage entrepreneurship (Owusu, 1997).

### 3.3.2 Export Processing Zones

Figure 11: “Can the establishment of an EPZ assist in the development of a viable export industry?”



Source: Own survey, 2003, N= 11/15.

Most manufacturers are aware of the phenomenon of export processing zones (EPZ), however, some of those who were aware of it, did not have in-depth knowledge. A significant proportion of manufacturers believed that an EPZ could only assist in the diversification of the economy through the attraction of FDI, if transport is subsidized. Another common thread in the responses is that, EPZs by their nature should ease access to ports or airports, which cannot happen in Botswana if transport is not subsidized as the country is landlocked. Transport in Botswana was cited as being expensive by the respondents. This is a pertinent consideration, as the costs of transport are prohibitive in Africa in general; rail transport costs are double that of Asia, and air transport costs are four times higher than East Asia (Harvey et al, 2000).

Some of the respondents were of the view that an effective EPZ can only be established if labour is subsidized. Those who mentioned this issue were of the opinion that labour is



expensive in Botswana and would thus reduce competitiveness. The issue of labour is always a concern in EPZ's as countries usually offer exemptions from labour legislation to prospective investors, who then offer very low wages, which tends to set EPZ companies on a collision course with trade unions. This has been the case in countries such as Namibia, where trade unions have even commissioned esteemed academics to investigate the adverse effects of EPZs (Jauch, 2003). In the case of Botswana this might not be a problem as there is very little trade union activity and it is very difficult to register trade unions (Maipose, 2003).

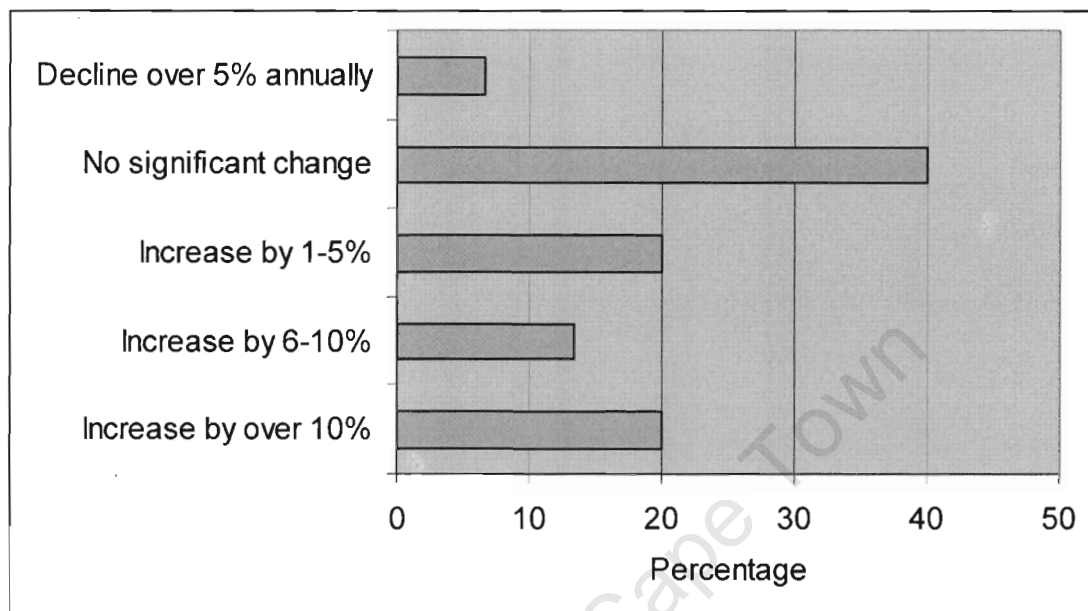
There were mixed responses from local businesses to the EPZ proposal. Some support the establishment of the EPZ with the hope that they will be able to benefit from the special incentives offered. Others were skeptical as they fear that EPZs provide additional advantages to foreign companies, which then use these advantages against local companies by selling cheaper products legally or illegally on the local market.

#### i) Assessment

Most manufacturers believe that for an EPZ to be successful in Botswana, some costs have to be subsidized. This applies to transport costs due to the geographical location of the country. This might not be possible as Botswana may be required to remove such subsidies in order to conform to WTO requirements. Also, the cost of the subsidization which includes forgone tax revenue and the procurement and servicing of land for new industries might outstrip the benefits of the establishment of an EPZ. Furthermore, EPZ companies have to export out of SACU because, if they export into SACU, Botswana has to collect the customs duty not paid on imported components of the product, which effectively increases per unit production costs and therefore the attractiveness of being part of an EPZ. An EPZ might, therefore, not be the best policy initiative to diversify the economy.

### 3.3.3 Expectation of future export performance

Figure 12: Expectation of export performance for the next year (in real terms).



Source: Own survey, 2003, N= 15.

From Figure 12 above, it is apparent that most manufacturers were optimistic about their future export performance. It is encouraging to note that about 20% were optimistic that their exports will increase by over 10%, which shows that the manufacturing sector is confident about the future growth in exports. If firms are optimistic about future business conditions they are more likely to forecast high rates of return on current investment and therefore may invest more (McConnel and Brue, 2002). This is likely to send positive signals to potential foreign investors, and greatly enhance the attractiveness of the sector.

## **CHAPTER FOUR: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

### ***4.1 SUMMARY AND CONCLUSIONS***

Botswana is still dependent on primary products for growth. However, there is a general consensus that the country has been characterized by good governance and prudent economic management (Maipose, 2003). As discussed, there still exists the challenges of diversifying the economy and empowering indigenous private entrepreneurs. This can be achieved through an energized/activated state facilitation role (Maipose, 2003). The latest development plan, NDP 9, shows that the government is thoroughly aware of this priority.

A country's policy environment can be an indication of its commitment to an ideal (Sader, 1990). Most of the policies necessary to achieve economic diversification are already in place, including a stable exchange rate policy, low tax rates and to some extent, the availability of industrial and commercial plots; which have long been cited as one of the key problems inhibiting investment. The creation of an agency dedicated to the promotion of investments and exports (BEDIA), the establishment of an international financial services centre (IFSC) and the priority given to education as a way of supplying trainable employees. However, the results of these efforts to facilitate investment have not been as expected.

Even though lack of skilled personnel has been cited as a barrier to investment, this study has shown that the lack of skills was a significant, but not insurmountable factor when the decision to invest is undertaken.

Botswana has an open economy, which is however, considered to be closed by certain quarters as SACU as a whole has been highly protected. This is in line with the survey findings as illustrated by Figure 8 (pg 34), which shows that trade mostly exists only on a regional basis. However, it can be surmised that regional integration will be a stepping

stone to globalization in the long run. Currently globalization affects Botswana more through its impact on South Africa than through any direct impact on the country. This unusual situation exists because Botswana as a member of SACU has committed itself to completely free trade with other members, as such it is only affected by globalization to the extent that South Africa – being the regional powerhouse – has liberalized its trade policy and, by definition, that of SACU (Siphambe, 2003). However, one needs to take cognizance of the fact that globalization and liberalization might be detrimental to the development of Small and Medium Enterprises (SME's). As some respondents noted, it will mean that government may in the future be required to reduce or remove fiscal incentives (such as the 15% manufacturing tax) for manufacturing firms, as it is a signatory to the WTO. This could be disastrous as most SME's, which in our survey was about 80%, depend on incentives and subsidies from government schemes such as CEDA.

The primary motive for investment, seems to be the exploitation of the domestic market. Most investors tend to be locals. This can suggest that the type of investment that the government would like to attract, which is manufacturing for export to non-regional markets has not been sufficiently realised. Most of the surveyed manufacturers were principally seeking the national market, which tends to suggest that they had a limited scale of operation due to the small size of the local market. The fact that they are able to export to South Africa and other countries in the region, albeit on a small scale tends to suggest that there is a shift from import substitution to export orientation. Also the fact that most were optimistic about future performance indicates potential for future export growth.

## **4.2 RECOMMENDATIONS**

### **4.2.1 Incentives**

Incentives have been utilized by many policy makers as a measure to motivate private investors to make investments. Botswana had gone this route through the introduction of financial incentives such as the FAP, which has proved ineffective due to widespread abuse. This programme is being phased-out and some aspects of it will be incorporated into CEDA, which provides finance and mentoring for projects, with special emphasis on manufacturing. The country has also introduced a very low 15% manufacturing tax rate as a form of fiscal incentive.

Even though the issue of incentives tends to elicit differing views, this paper has indicated that incentives have been instrumental in the facilitation of investment. They mainly achieved this by providing the essential start-up finance and assisting the companies to acquire industrial or commercial plots. Most firms indicated that incentives, especially FAP, 15% manufacturing tax and to some extent the Local Procurement Programme (LPP); which reserves 30% of government purchases for locally based manufacturing enterprises, have a crucial and positive impact on their day to day operations. These schemes, especially the FAP, assisted the companies to increase market share. The author subscribes to the school of thought which states that a credible investor's concern is long term profitability. However, it is this paper's assertion that the incentive schemes can be useful in mitigating against minor inconveniences of locating in a third world country such as somewhat slow bureaucratic procedures. Taking cognizance of the fact that most manufacturers stated that the incentives were adequate and essential and that the incentives had a bearing on the operations of the firms, it is the recommendation of this paper that the incentive schemes which have an emphasis on manufacturing like CEDA should be retained.

#### 4.2.2 Export Processing Zone

Another means utilized to attract FDI is the establishment of EPZs. This policy intervention could be used in the case of Botswana to promote the rapid growth of manufactured exports, with the aim of both creating employment and boosting economic development. An issue to note, however, is that under the SACU agreement even if the imports needed to make a good are initially allowed into Botswana duty free, once a good is exported to the Union, Botswana is required to collect the customs duty not paid on the imported components of the product. As a result, a traditional EPZ could only operate in the country if the exporters are selling their products entirely outside SACU. This might be a problem as most investors would like to export to the South African market (UNCTAD, 2002). Another consideration is that most respondents stated that due to the geographical location and the relatively expensive labour, there will be a need to subsidize transport and labour. Given that Botswana is a signatory to the WTO, this might not be feasible. Also an attempt to introduce EPZs as a solution to our economic problems is likely to threaten attempts towards regional economic integration, which is also a perception held by Keet (1996) on the effects of these entities on regional integration as they tend to promote “beggar thy neighbour” policies. This occurs as countries continually offer huge incentives – sometimes to the detriment of welfare – to potential investors, so as to dissuade them from investing in neighbouring countries.

Also, the funds utilized in the establishment of such an entity might far outweigh the benefits, as the net foreign earnings might not be adequate to warrant such investment. This can be the case if the domestic linkages are weak, which is likely to apply to the Botswana scenario. There are also welfare implications of such establishments, as is the present case in Namibia where the government is embroiled in a bitter dispute with its trade unions over working conditions in its EPZ (Jauch, 2003). The most important justification for the establishment of EPZs in other developing countries is that they allow export orientated firms to avoid much of the heavy taxation and bureaucratic regulations that exist in such countries. As Botswana has instituted very low tax rates and liberalised financial regulations, this justification is not relevant to the country. The recommendation

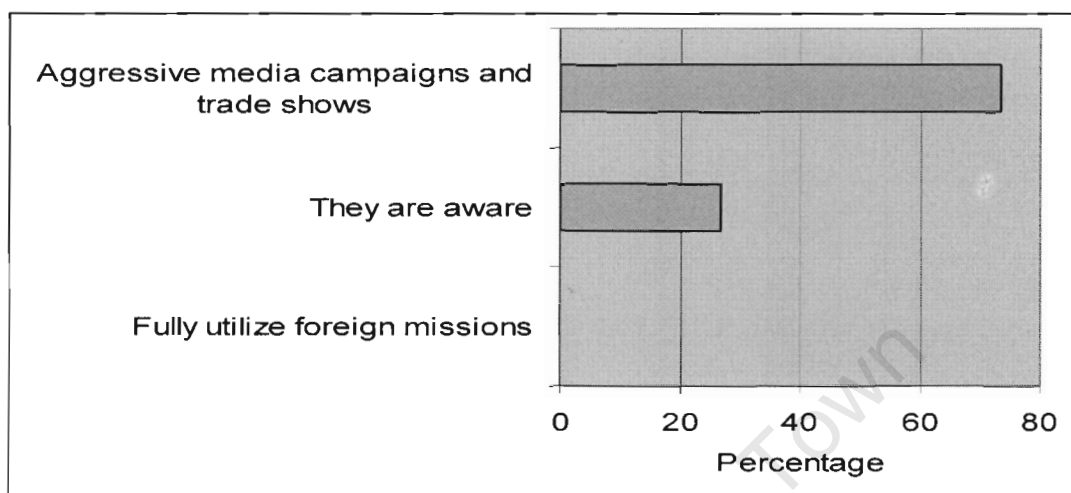
of this paper is that this type of investment promotion programme is not suitable for Botswana.

#### **4.2.3 Investment promotion strategy**

There is generally a consensus that the current government has endeavoured to create an environment that is conducive to foreign investment. It has also succeeded in alleviating most of the factors that had been cited as disadvantageous to investment. There is also a prevailing belief amongst manufacturers that the country is an attractive investment destination, with an unsurprising 100% holding the opinion that the country possesses a sound economic environment. The issue to consider is how to translate such appealing characteristics into tangible investment.

It is the opinion and the most important recommendation of this paper that the answer lies in a comprehensive investment promotion strategy. Investment promotion, as Wells *et al* (1990) noted, should be able to provide information to potential investors, create an attractive image of the country as a place to invest, and provide services to a prospective investor. Given that the country is an economically sound and attractive destination, the task of promotion has to be principally focussed on making this fact “visible”. This will entail, as figure 13 below illustrates, aggressive media campaigns and active utilization of trade shows. Even though the respondents were aware that these efforts are being undertaken the emphasis was on the degree of implementation. They believed that there was a need for a concerted marketing and public relations effort, which should be accompanied by an improvement in bureaucratic procedures.

Figure 13: Ways of raising awareness of Botswana as an attractive investment destination.



Source: Own survey 2003, N= 4/15

A significant minority of the respondents felt that potential investors were aware of the attractiveness of Botswana as an investment destination. However, such a response can be credited to self-interest, as some felt that an influx of investors will reduce their market share. None felt that using foreign missions such as consulates would be useful as they felt that such missions might not have the requisite industry experience to adequately represent the business industry, in particular the manufacturing sector.

As regards the investment promotion strategy, a basic requirement is that the strategy should inculcate awareness and a subjective preference for Botswana. This will require a coordinated marketing and communication strategy that seeks, first and foremost, to ensure that potential investors are enticed to visit the country (Hawkins and Lockwood, 2001).

To attain this, the strategy should first have such fundamentals as; communication targeted at the most influential foreign financial print and an electronic media that is constantly updated and has links to most economic agencies in Botswana, the marketing of Botswana as a holiday and a business tourism destination and the securing of major



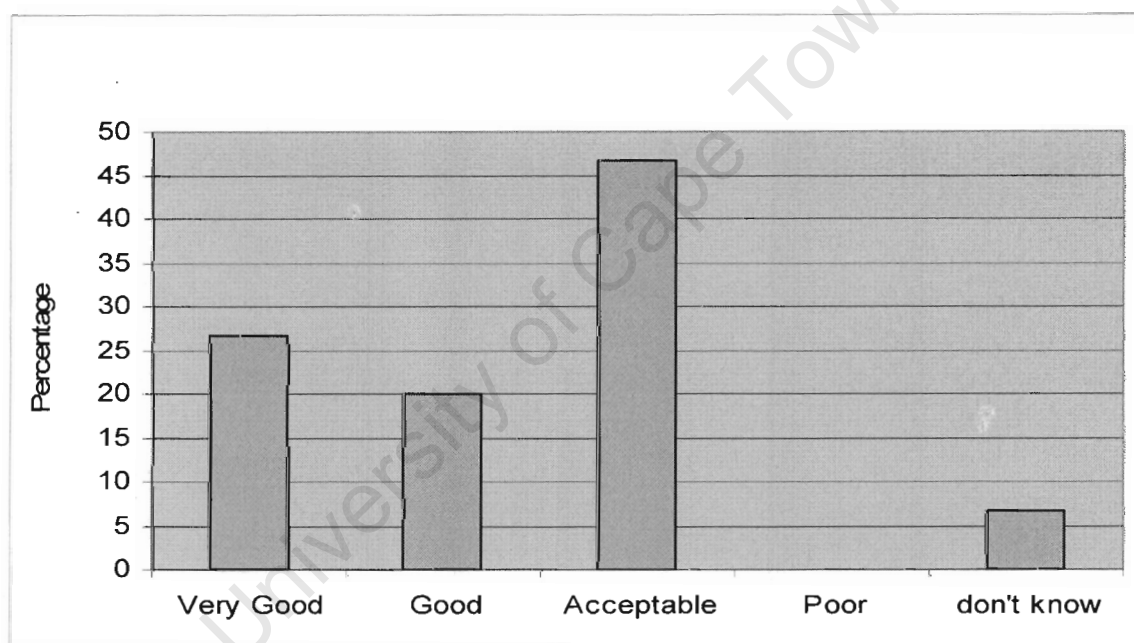
international events that “showcase” the country. Incentives, which are already in existence, can be utilised as part of the strategy elements to indicate that the country is “open for business” (Sader, 1990).

The second part of the strategy will entail a consistent effort to create a welcoming environment for investors. The attitude towards prospective investors is a crucial, though for the most part, neglected element. The success of Mauritius in attracting investment was in part credited to the excellent welcoming environment to foreigners (Cowan and Phetwe, 1997). Even though most surveyed manufacturers were generally positive about the service that they get from government, with 53% stating that it is good, and about 13% stated that it is very good, most had a distinct impression that they were tolerated but despised “Batswakwa” or outsiders, which they believe is a response to their perceived affluence. This could be overcome through a national campaign to highlight the worth of foreign investors and improved access to high level service from specially identified and trained officials in relevant government departments.

A third part of the strategy will entail the targeting of specific projects for foreign and local investment. In order to proceed from awareness and an expression of interest to committed investment, it may be necessary to assist with the identification of niche investment opportunities (Hawkins and Lockwood, 2001). It is interesting to note that the Botswana Enterprise Development and Investment agency (BEDIA) which is tasked with increasing investment facilitation has adopted this part of the strategy. However, the approach has met with mixed success and needs an entrepreneurial edge that combines sectoral and technical knowledge with an awareness of the business environment. This is currently not the case, as this mandate is conferred upon lowly placed officers, who tend to be university graduates and former government officers with no industry experience. This ideal can be achieved if such tasks are performed by industry consultants with the requisite aptitude and experience. Such an approach may be achieved through the allotment of a commission based payment, which is related to the size of investment made or the number of jobs undertaken and sustained. The payments could be in tranches; subject to investment being undertaken.

It is encouraging to note that the current development plan has seen the need to develop strategies to attract FDI, and boost domestic investment within the plan period. It is the recommendation of this paper that, for that strategy to be successful, it must encompass elements of the investment promotion strategy highlighted above. It is also the recommendation of this paper that such a strategy should be under the auspices of BEDIA, due to the fact that such an activity requires a flexible agency which is not hindered by government bureaucracy. Also, most of the respondents had a favourable impression of the performance of the agency, as denoted by Figure 14.

Figure 14: The performance of BEDIA



Source: Own survey 2003, N= 13/15

Another factor that needs to be emphasized is that even though most manufacturers are content with government administrative procedures, they cite the need for a more streamlined process, which will facilitate the effortless and seamless entry of new businesses into the country. Such a process can be established through the founding of a “one-stop shop”. During the 1980’s the concept of a “one-stop-shop”, which is basically a coordinating mechanism which ensures that the investor attains all the necessary

clearances, had found favour as a vehicle to deal with administrative barriers (Sader, 1990). BEDIA has established such an entity, however, none of the respondents had been assisted by BEDIA's "one-stop-shop", due to its recent inception, and as such there was no opinion on its effectiveness. However, the establishment of such an entity is a step in the right direction and is highly recommended.

The proposed multi-tiered investment promotion strategy will raise awareness of Botswana as an investment destination, facilitate the ease of entry into the country and identify and procure relevant valuable projects, whilst employing revamped existing agencies such as BEDIA. It should be taken into account that it is investment projects that ensure economic growth and diversification. Even though the establishment of an EPZ is not the best policy decision, efforts to attract export-orientated private investment such as outlined above can be successful, if the Botswana government continues to commit itself to prudent economic planning and policy implementation.

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## APPENDIX 1

### QUESTIONNAIRE FOR SURVEY ON EXPORT ORIENTATED MANUFACTURERS

#### QUESTONS

1. In what part of Botswana are you principally located?
  1. Gaborone
  2. Selibe Phikwe
  3. Francistown
  4. Lobatse
2. When was the firm established? -----(State year)
3. How many Plants does your firm operate?----- (State actual number))
4. Is your firm a subsidiary of foreign organization?
  1. yes
  2. no

*If no proceed to Qs. 6*
- 5 a. If, yes, to what extent is your firm integrated into the global network of your parent company?
  1. fully integrated
  2. partly integrated
  3. not integrated
- 5b. Does this have an impact in your production process?
  1. yes
  2. no
- 5c. If, so, why?
  1. use of license
  2. business strategy
  3. use of license and business strategy
  4. availability of technical expertise

6. What is your firm's origin?

1. Botswana
2. South Africa
2. Other African Countries (excluding South Africa)
3. Global (Specify) .....

7. What is your firm's annual turnover?

1. 0 to P 10 million
2. P10 million to P 50 million
3. P 50 million to P 100 million
4. P 100 million to P 150 million
5. P 150 million and over

8. In which sector of the economy are you engaged in?------(State)

#### **B. FACTORS AFFECTING THE LOCATION DECISION MAKING PROCESS**

9. Was the firm previously located elsewhere?

- 1 Yes
- 2 no

10. If, so, why did it relocate to Botswana?

1. Securing Botswana market share
2. Access to Botswana Market
3. Access to SADC market
4. Attractive economic climate



11.

Please rank the importance of factors encouraging investment in Botswana on a scale of 1 to 4 (1 being very important and 4 denoting not important).

a. Access to South African market

b. Low tax rates

c. Access to financial Services

d. Good governance

e. Strong Macroeconomic fundamentals

f. Political Stability

g. Less bureaucracy

h. Easy access of work permits for expatriate workers

i. Rapid economic growth

j. Proximity to suppliers

k. Good/low cost infrastructure

l. Access to Botswana Market

m. cheap skilled labour


12.

Specify the principal reason that motivated you to locate in this particular locality.

1 Proximity to support industries

2 Availability of land

3 Proximity to Market

13.

Do you believe that government incentives played a role in your location decision making process?

1. yes

2. no

If answer no, continue to Qs. 15

14.

If, so, can you elaborate the role?

1. Assisted the company with the crucial start-up process by providing finance and securing land

2. Assisted the company to secure market share through FAP sales augmentation and unskilled labour grant

3. Through 1 and 2 above.

15. Do you believe that other firms not in Botswana are aware of government incentives?

1. yes
2. no

*If yes, continue to 17*

16. If not, how can the government make its incentives more “visible” globally?

1. Active and efficient participation in trade seminars.
2. Aggressive media campaigns and active participation in trade shows
3. Full utilization of foreign missions
4. Current efforts are adequate

17. What Government incentives does your firm utilize?

1. FAP
2. Manufactures 15% tax
3. CEDA
4. LPP
5. None
6. 1 & 2
7. 1, 2 & 4
8. 1, 2 & 3
9. 1 & 3
10. 2 & 4

18. How important are the Government incentives in the operations of your firm?

1. Very Useful
2. Helpful to a limited extent
3. Do not have any impact

19. If incentives are not attractive what can be done to make them more attractive?

1. Tailor them to the needs of established companies.
2. Improve the implementation of the incentives
3. Extend repayment window period
4. They are attractive

20. Do you believe that the economic environment of Botswana is sound?

1. yes
2. no

*If no continue to number 22*

21. If yes, how can potential investors be made aware of this factor?

1. They are aware
2. Aggressive utilization of the media and active participation in trade shows
3. Greater utilization foreign missions

22. How do you rank the performance of Botswana Export Development and Investment Authority in attracting investors and making sure that investors are welcome into the country?

1. Poor
2. Acceptable
3. Good
4. Very Good

23. Has BEDIA's "One Stop Shop" helped your firm to get around administrative bottlenecks?

1. Yes
2. No

24. How can the performance of this institution be improved?

1. Active and efficient participation in trade seminars.
2. Aggressive utilization of the media and active participation in trade shows
3. Full utilization of foreign missions
4. Current efforts are adequate

25a. Is the company aware of the availability of capital funds and working finance from the National Development Bank?

1. Yes
2. No

25b. Has it utilized this facility?

- 1. Yes
- 2. No

22c. When?----- (State year)

26. The following factors have been cited in the past as key problems facing the development of a viable export industry. Do you believe that they are still important? Rank on a scale of 1 to 4 (1 denoting very important and 4 denoting not important).

- |   |  |  |  |
|---|--|--|--|
| 1 | Shortage of serviced land for industry.            | <table border="1"><tr><td></td></tr></table> |  |
|   |  |  |  |
| 2 | Lack of entrepreneurial and technical skills       | <table border="1"><tr><td></td></tr></table> |  |
|   |  |  |  |
| 3 | Restrictive Government regulatory constraints      | <table border="1"><tr><td></td></tr></table> |  |
|   |  |  |  |
| 4 | High level of tariffs on inputs from outside SACU. | <table border="1"><tr><td></td></tr></table> |  |
|   |  |  |  |

27. Are you aware of what is an Export Processing Zone (EPZ)?

- 1 Yes
- 2 No

28. If, yes, do you think that the establishment of an EPZ can help solve these problems?

- 1. Only if there are transport subsidies
- 2. Only if labour is subsidized
- 3. It will not solve the problems
- 4. It will solve the problems

**C. MARKET**

29. Please list items that you produce?

- 1. School and work uniforms
- 2. Protective wear
- 3. Bathing accessories (face cloths, towels etc)
- 4. Items made with PVC
- 5. Paints
- 6. Synthetic braids
- 7. Tiles

30. What percentage of total sales were exports in the last three financial years?  
(State Percentages)

YEAR	PERCENTAGE
a	
b	
c	

31. Please indicate the percentage content of your main inputs. (State Percentages)

1. Botswana\_\_\_\_\_
2. SADC\_\_\_\_\_
3. European Union\_\_\_\_\_
4. North America\_\_\_\_\_
5. Other:\_\_\_\_\_

32 Do you expect exports to increase/decline in real terms?

	a. Next Year	b. Next Five years
1. Decline by over 5% annually		
2. Decline by 1-5% annually		
3. No significant change		
4. Increase by 1-5% annually		
5. Increase by 6-10% annually		
6. Increase by over 10% annually		

33. Which of the following do you consider your principal market?(State percentages)

1. South Africa
- 2 Botswana
- 3 Other SADC
- 4 Global (outside SADC) (specify country).....

Percentages

34. In which country are your major competitors located?

- 1 South Africa
- 2 Other African countries
- 3 Botswana
- 4 Zimbabwe

35. What is your perception of the sources of the manufacturing sector growth in Botswana? Give Percentages. (State percentages)

- 1 Rising domestic demand
- 2 Import substitution
- 3 Exports
- 4 Others (specify).....


36. How do you rate the rate the assistance that you get from government institutions

- 1. Very Good
- 2. Good
- 3. Average
- 4. Bad
- 5. Very bad

37. In your opinion what can be done to improve this service?

- 1 They should be more accommodating to customer needs.
- 2 They should give preferential treatment to manufacturers
- 3 Give continuous feedback
- 4 have a more service oriented attitude

Thank you for your co-operation.